UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	:	Chapter 9
NEW YORK CITY OFF-TRACK BETTING CORPORATION,	:	Case No. 09-17121 (MG)
Debtor.	:	

ORDER REGARDING MOTION TO APPROVE DISCLOSURE STATEMENT

The Debtor's motion to approve the first amended disclosure statement and solicitation procedures in this chapter 9 case came on for hearing on November 30, 2010. The Court heard argument on objections by Catskill Regional Off-Track Betting Corp. ("Catskill") and Standardbred Owners Association, Inc. ("SOA"). Catskill's objection was resolved, in part, by Debtor's agreement to add language to the disclosure statement. Catskill's remaining objection to the definition used for Class 3 creditors was overruled on the record.

After hearing lengthy argument regarding SOA's objection that the disclosure statement and plan include impermissible provisions for exculpation and third-party releases, the Court took the matter under submission to decide, in the first instance, whether issues that clearly will be issues for confirmation should be decided now, or whether the issues should be reserved for the confirmation hearing.

SOA does not contend that it is a creditor of the Debtor. Rather, SOA asserts that it has a contract with Yonkers Racing Corporation ("Yonkers"), the Debtor's second largest unsecured creditor and a member of the Creditors' Committee, entitling SOA (or its members) to receive 50% of any payments Yonkers receives from the Debtor.

Yonkers is owed approximately $23 million by the Debtor, and SOA claims that it would be entitled to receive approximately $11.5 million from Yonkers *if* Yonkers recovered that amount from OTB. Under the proposed plan, Yonkers will not recover any cash, but will instead receive equity in a new entity holding a portion of the Debtor's business; 50% of any payments received by Yonkers as dividends in the future would then be contributed to a fund for SOA's members' benefit. SOA's counsel argued that SOA would have a claim against Yonkers for breach of the covenant of good faith and fair dealing arising from its contract with Yonkers *if* Yonkers compromises its $23 million claim against the Debtor through the proposed chapter 9 plan of adjustment. The exculpation and third-party release provisions on their face would appear to bar SOA from asserting its alleged claim against Yonkers.

For the reasons explained below, the Court decides to exercise its discretion to defer until confirmation SOA's objections to the exculpation and third-party release provisions.

Courts have discretion to consider confirmation issues before a confirmation hearing when the plan is not confirmable on its face. *See In re Main Street AC, Inc.*, 234 B.R. 771, 775 (Bankr. N.D. Cal. 1999) ("It is now well accepted that a court *may* disapprove of a disclosure statement, even if it provides adequate information about a proposed plan, if the plan could not possibly be confirmed.") (emphasis added); *see also In re Phoenix Petroleum Co.*, 278 B.R. 385, 394 (Bankr. E.D. Pa. 2001); *In re Canandaigua Props., Inc.*, 140 B.R. 616, 618 (Bankr. W.D.N.Y. 1992); *In re S.E.T. Income Props., III*, 83 B.R. 791, 792 (Bankr. N.D. Okla. 1988) ("A clear showing that the plan is not confirmable justifies denial of the sufficiency of the disclosure statement to avoid the cost and delay of a fruitless venture.”). Courts should not, however, turn the disclosure statement hearing into a hearing on confirmation; objections should be limited to those that cannot be cured by voting. *In re Copy Crafters Quickprint, Inc.*, 92 B.R. 973, 980 (Bankr. N.D.N.Y. 1988).

SOA argues that its objections cannot be cured by confirmation because the plan includes exculpation and release provisions which the Court lacks subject matter jurisdiction to grant. SOA’s objections raise serious issues, and its position may well be correct. The Court has concluded, however, that it does not have a sufficient factual or legal record to resolve SOA’s objections at this time. In light of the Debtor’s precarious financial position, any delay in proceeding to confirmation may injure the Debtor and its creditors alike.

The Second Circuit’s recent opinion in *Travelers Casualty and Surety Co. v. Chubb Indemnity Insurance Co. (In re Johns-Manville Corp.)*, 600 F.3d 135 (2d Cir. 2010) (*per curiam*) (*“Manville II”*), *cert. denied*, 2010 WL 3286536 (November 29, 2010), adhering to the position in the earlier opinion by the same panel in *In re Johns-Manville*, 517 F.3d 52 (2d Cir. 2008), *rev’d on other grounds*, 129 S.Ct. 2195 (2009) (“*Manville I”*), states that “‘[A] bankruptcy court only has jurisdiction to enjoin third-party non-debtor claims that directly affect the *res* of the bankruptcy estate.’” 600 F.3d. at 146 (quoting *Manville I*, 517 F.3d at 66). The court went on to say that “Our reasoning was straightforward. The bankruptcy court’s power derives, in part, from statutes enacted by Congress. In the bankruptcy code, Congress has granted the . . . courts expansive bankruptcy jurisdiction to adjudicate claims against a debtor’s estate. The jurisdiction is *in rem* in nature; it permits a determination of all claims that anyone, whether named in the action or not, has *to the property* or thing in question." *Id.* at 152 (internal quotation marks and citations omitted). In *Manville I*, the plaintiffs sought recovery directly from the debtor's insurer for the insurer's independent wrongdoing and raised no claim against the debtor's insurance coverage. *Manville I*, 517 F.3d at 65. The court ruled that since the plaintiffs made no claim against an asset of the bankruptcy estate, and their action did not affect the estate, the bankruptcy court lacked jurisdiction to enjoin claims against the debtor's insurer. *Id.*

Recently, Judge Bernstein dealt with the issue of third-party non-debtor releases in *In re Dreier*, 429 B.R. 112, 131 (Bankr. S.D.N.Y. 2010). Judge Bernstein stated that:

> In assessing a court's jurisdiction to enjoin a third party dispute, the question is not whether the court has jurisdiction over the settlement, but whether it has jurisdiction over the attempts to enjoin creditors' unasserted claims against the third party. 'Related to' jurisdiction to enjoin a third party dispute exists where the subject of the third party dispute is property of the estate, or the dispute would have an effect on the estate.

Id. at 131 (internal quotation marks and citations omitted); *see also Shearson Lehman Bros., Inc. v. Munford, Inc. (In re Munford, Inc.)*, 97 F.3d 449, 454 (11th Cir. 1996) ("It is not the language of the settlement agreement that confers subject matter jurisdiction in this case. Rather, it is the 'nexus' of those claims to the settlement agreement . . . that the bankruptcy court must approve"). The court went on to say that "before the Bankruptcy Court decides whether the proponent of a plan settlement has demonstrated the 'unusual circumstances' mandated by *Metromedia*, it must first decide whether it has subject matter jurisdiction." *Id.* at 132.

The reference to *Metromedia* is to the Second Circuit's earlier decision in *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 141 (2d Cir. 2005). The case makes clear that non-debtor releases should not be approved "absent the finding that truly unusual circumstances render the release terms important to success of the plan." *See* 416 F.3d at 143. The bankruptcy judge must make a factual finding of the importance of the release after presentation of evidence supporting such a finding. *Id.* In making this determination, courts consider factors such as whether the estate received substantial consideration in return for the release, and whether the enjoined claims are "channeled" to a settlement fund rather than extinguished. *In re Karta Corp.*, 342 B.R. 45, 54 (S.D.N.Y. 2006) (citing *In re Drexel Burnham Lambert Group, Inc.*, 960 F.2d 285, 293 (2d Cir. 1992)). The Second Circuit's *Manville* decisions make clear, however, that the bankruptcy court must first determine that it has subject matter jurisdiction before reaching the "truly unusual circumstances" test. In addition to arguing that the Court lacks subject matter jurisdiction, SOA also argues that the "truly unusual circumstances" test is not satisfied here. The Court requires an evidentiary record, absent at the present time, before making this determination.

There may be an important distinction in this case from the circumstances in *Manville*, *Metromedia* and *Dreier*. All three of those cases involved releases of third-party claims arising from pre-petition conduct. The courts in *Manville* and *Dreier* specifically focused on whether the courts had "related to" subject matter jurisdiction. Here, however, SOA argues that Yonkers' proposed compromise of its claims during the course of this chapter 9 case, both as a member of the Creditors' Committee and as a creditor, is the conduct that will give rise to SOA's state law claim for breach of the covenant of good faith and fair dealing. The Court raised questions during the argument whether, in these circumstances, this Court has "arising in" jurisdiction to approve the exculpation and third-party release provisions under 28 U.S.C. § 1334(b). None of the parties' briefs addressed "arising in" jurisdiction. But threats against a member of the Creditors' Committee that it will be sued if it recommends and approves a plan that compromises unsecured creditors claims would seem, at first blush at least, to fit within the "arising in" category. Recently, the Second Circuit held in *Baker v. Simpson*, 613 F.3d 346 (2d Cir. 2010), that claims of professional malpractice based on services rendered pursuant to a bankruptcy petition fall within the bankruptcy court's "arising in" jurisdiction. *Id.* at 349. The court held that "the determinative issue is whether claims that appear to be based in state law are really an extension of the proceedings already before the bankruptcy court." *Id.* at 350. Recognizing that the definition of a proceeding "arising in" Title 11 is not entirely clear, the court stated that "it covers claims that 'are not based on any right expressly created by [T]itle 11, but nevertheless, would have no existence outside the bankruptcy.'" *Id.* at 351 (quoting *In re Wood*, 825 F.2d 90, 97 (5th Cir. 1987)). The *Baker* court focused on the fact that the malpractice claim "implicates the integrity of the entire bankruptcy process." *Id.* (quoting *In re Seven Fields Dev. Corp.*, 505 F.3d 237, 269 (3d Cir. 2007). While SOA has not filed a claim in this case, and is not a professional retained by any party in interest, it readily admits that it is attempting to derail confirmation of the plan of arrangement proposed by the Debtor. It may well be that these circumstances fit *Baker*'s standards that it "would have no existence outside of the bankruptcy," and likewise "implicates the integrity of the entire bankruptcy process." The Court does not decide these issues now, but development of the facts and law will be required to resolve the issues at the time of confirmation. And even if the Court has "arising in" jurisdiction with respect to these contentions, it is not at all clear that the Court can approve exculpation or a third-party release without an adversary proceeding or contested matter examining the merits of SOA's and Yonkers' assertions.

For now at least the Court decides no more than that the disclosure statement and solicitation procedures are approved. The Debtor's counsel represented at the hearing that there are only approximately 100 general unsecured creditors so that the costs of proceeding to the next phase of this case should not be inordinately high.

The Debtor's counsel shall submit an order approving the disclosure statement and solicitation materials, permitting the case to proceed to the confirmation hearing on a schedule previously set by the Court.

IT IS SO ORDERED.

DATED: December 1, 2010
New York, New York

_____/s/Martin Glenn____________
MARTIN GLENN
United States Bankruptcy Judge